

Appeal from a decision of the Eastern States Office, Bureau of Land Management, rejecting the high bid in a competitive oil and gas lease sale. ES 34443.

Affirmed.

1. Oil and Gas Leases: Competitive Leases--Oil and Gas Leases:  
Discretion to Lease

The Secretary of the Interior has the discretionary authority to reject a high bid in a competitive oil and gas lease sale where the record discloses a rational basis for the conclusion that the amount of the bid was inadequate.

2. Oil and Gas Leases: Competitive Leases--Oil and Gas Leases:  
Discretion to Lease

The Department is entitled to rely on the reasoned analysis of its technical experts in matters concerning geologic evaluation of tracts of land offered at a sale of competitive oil and gas leases. Where a decision to reject a bid has been made in a careful and systematic manner utilizing the advice of such experts, the decision will not be reversed in the absence of a showing of error.

3. Oil and Gas Leases: Generally--Oil and Gas Leases: Competitive Leases

The number of bids received at a sale of competitive oil and gas leases on any parcel does not necessarily represent an accurate test of fair market value, as bidders may consider other factors in making their bids.

4. Oil and Gas Leases: Competitive Leases--Evidence: Burden of Proof

When the Government rejects a competitive oil and gas lease high bid because it was less than the presale tract valuation and presents sufficient documentation

supporting its valuation, the bidder must not only disprove the Government's fair market value estimates, but must also prove that his bid constitutes fair market value.

APPEARANCES: Gary G. Broeder, Esq., Billings, Montana, for appellant; Mary Katherine Ishee, Esq., Alexandria, Virginia, for the Bureau of Land Management.

#### OPINION BY ADMINISTRATIVE JUDGE KELLY

I. K. Rosen has appealed from a March 4, 1985, decision of the Eastern States Office, Bureau of Land Management (BLM), rejecting his high bid for parcel 10 1/ (ES 34443) in BLM's December 10, 1984, competitive oil and gas lease sale. 2/ In its decision, BLM cited its appraisal of this parcel, which was \$25 per acre, as compared with appellant's bid of \$5.30. 3/

With his notice of appeal, appellant filed a request for production of documents relating to BLM's evaluation of this parcel, as well as parcel 9, for which he submitted no bid. BLM requested the Board to remand the cases so it could provide appellant with the requested documents. In the interest of efficient adjudication, the Board by order dated May 2, 1985, retained jurisdiction and directed BLM to respond to appellant's request, serving copies of its response on the Board. On September 4, 1985, BLM filed with the Board its Fair Market Value (FMV) Appraisal for parcel 10. With his statement of reasons, appellant submitted the report of a certified petroleum geologist disputing the BLM appraisal. In rebuttal, BLM has submitted a Response to Statement of Reasons by the Eastern States Deputy State Director of Mineral Resources.

[1] The Secretary of the Interior has discretionary authority to reject a high bid for a competitive oil and gas lease as inadequate. 30 U.S.C. § 226(b) (1982); Michael Shearn, 87 IBLA 168 (1985); Ronald C. Agel, 83 IBLA

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1/ Parcel 10 is located in Newaygo County, Michigan, within the Manistee National Forest and within the Goodwell-Norwich known Geologic Structure. The parcel is within the Goodwell-Norwich Field and is described as follows:

Parcel No. 10 - 140.0 acres  
T. 14 N., R. 11 W., Michigan Meridian  
Section 10: N 1/2 NW 1/4 SW 1/4;  
NE 1/4 SW 1/4;  
N 1/2 SE 1/4

Newaygo County, Michigan

2/ Appellant also appealed BLM's Mar. 4, 1985, rejection of his high bid for parcel 11 (ES 34444), but subsequently filed a request on June 19, 1986, to withdraw his appeal as to that parcel. By order dated July 2, 1986, the Board granted appellant's request and dismissed the appeal as to parcel 11.

3/ We note the BLM appraisal at page 5 incorrectly shows the high bid for parcel 10 to be \$16. The lease bid form in the record shows the bid to be \$5.30.

204]&76 (1984); Viking Resources Corp., 80 IBLA 245 (1984); Edward L. Johnson, 73 IBLA 253 (1983). This Board has consistently upheld that authority, so long as there is a rational basis for the conclusion that the highest bid does not represent FMV for the parcel. Clarence Sherman, 82 IBLA 64, 65 (1984); Viking Resources Corp., *supra* at 246; Glen M. Hedge, 73 IBLA 377, 378-79 (1983); Edward L. Johnson, *supra* at 254-55.

[2] In exercising the Secretary's authority to reject a high bid, the Department is entitled to rely on the reasoned analysis of its technical experts in matters involving geologic evaluation of tracts of land offered at a sale of competitive oil and gas leases. Viking Resources Corp., *supra* at 247; L. B. Blake, 67 IBLA 103 (1982). However, when BLM relies on that analysis in rejecting a bid as inadequate, it must ensure that a reasoned explanation is provided in the record to support the decision. Mesa Petroleum Co., 81 IBLA 194, 195 (1984); Edward L. Johnson, *supra* at 255. If the bid is not clearly spurious or unreasonable on its face, the Board has consistently held that absent such explanation, the decision must be set aside and the case remanded for compilation of a more complete record and readjudication of the acceptability of the bid. Kevin J. Bliss, 82 IBLA 31, 32 (1984); Edward L. Johnson, *supra* at 255.

Accordingly, we first address the question of whether there was a rational basis, supported by a reasoned explanation in the record, for BLM's conclusion that appellant's bid for parcel 10 did not represent fair market value. In its statement of reasons, appellant alleges BLM's appraisal does not reasonably support BLM's decision in several respects. In describing geology and trap type for this parcel, BLM's fair market value appraisal mentions the Michigan Stray Sand formation. The report of appellant's geologist (Helmholtz report) states that the Michigan Stray Sand should not have been used to predict the outline of deeper pools that might underlie parcel 10. BLM's response memorandum agrees that the Michigan Stray Sand "is not conformable" with the Deeper Traverse Lime and Reed City Dolomite (which are conformable with each other) and so cannot be used to predict their structure." BLM asserts, however, that the Michigan Stray Sand was not in fact used in its appraisal and should not have been referred to in its appraisal report.

Appellant challenges the reservoir data and recoverable reserves for parcel 10 which are discussed as follows in BLM's appraisal:

The reservoir data was obtained from Petroleum Information completion cards for wells in the area and from the Michigan Basin Geological Society Oil and Gas Field Symposium, 1968. This data was used to determine the estimated recoverable reserves from the tract. Although the tract is quite large, a homogeneous reservoir was assumed and any minor anomalies in the reservoir are considered insignificant.

The reservoir parameters of the subject tract are as follows:

Target Depth:	Reed City Dolomite at 3,750 feet
Net Pay:	25 Feet
Porosity:	13.0 percent
Bottom Hole Pressure:	1,428 psig
Bottom Hole Temperature:	590 degrees R
Water Saturation:	35.0 percent
Oil Saturation:	65.0 percent
Oil Recovery Factor:	10.0 percent
Gas/Oil Ratio:	1,000 cu ft/STB
Dry Hole Risk Factor:	90.0 percent
Oil Formation Volume Factor:	1.2 bbl/STB
Permeability	20-40 md

Using standard volumetric methods for an oil reservoir, the recoverable oil and associated gas reserves were calculated. The results of the volumetric analysis are as follows:

<u>Acreage</u>	<u>Recoverable Reserves</u>		<u>Reserves</u>		Total Recoverable
	<u>Oil (bbl/acre)</u>	<u>Gas (MCF/acre)</u>	<u>Oil (bbl)</u>	<u>Gas (MCF)</u>	
140.00	1,365	1,365	191,100	191,100	

Based on 40-acre spacing of wells in this field, the volumetric analysis showed that 54,600 STB of oil and 54,600 MCF of gas are recoverable from each successful well drilled on this tract.

FMV appraisal at 2-3.

The Helmboldt report characterizes these figures as "pure fantasy." It states in part:

The Reed City Dolomite underlies the Traverse structure by 630'+. From cores and logs, the water contact is -2402' so using the Traverse Lime structural map and adding 630' to values under Parcel 10 would indicate expected depths of -2410' to -2430' which is below the water contact. To be profitable, a well should top the Reed City Dolomite at least 10' above the water contact so anything below -2392 would be undesirable.

The reserves estimate included in the Fair Market Value report of the Bureau of Land Management dated August 30, 1985 is only valid if you have reserves. If the pay thickness is zero, then there are no reserves; if the water saturation is 100% - again, no reserves. As the expected Reed City Top would be below the oil - water contact, both of these factors are probable. The parameters shown for Parcel 10 show a dry hole risk factor of 90%. If this means a one out of ten success ratio, it appears very optimistic. If it means a nine out of ten success ratio, it would have to be based on the Reed city Dolomite being conformable to the Michigan Stray, which is invalid as explained above.

In either instance, this number (90%) was not used in reserve calculations. The reserve calculations show all 140 acres would be productive, and all would produce the same amount; even though there would be 20'+ difference in structure and one mile distance difference from the crest of the high in Section 8. Again, the BLM assumptions relative to reserves are unrealistic given the available data. In my opinion the probable reserves estimate for the formations in question is zero.

Helmboldt report at 3.

In its response memorandum, BLM does not dispute the -2,402' figure for oil-water contact in the Reed City Dolomite. It does disagree with Helmboldt's prediction of 100% water saturation and zero pay thickness for parcel 10 in this horizon. According to BLM's interpretation, structure contours indicate that the bulk of parcel 10 is well above the oil-water contact depth of -2,402'. This finding is supported by an analysis of parcel 9 which is structurally similar to parcel 10. Thus, BLM considers the two parcels to be "geologically comparable, and therefore to have similar market values (assuming all other comparability criteria to be equal)."

With respect to the dry hole risk factor of 90 percent, BLM's response memorandum concedes that its appraisal did not consider this factor in computing estimated recoverable reserves but explains such reserves were based on recoverable oil and gas from successful wells:

Mr. Helmboldt is correct in his interpretation that the figure shown for total recoverable reserves in our FMV Appraisal of this parcel did not take into consideration the 90 percent dry hole risk factor, but rather assumed no dry hole risk. Although the format chosen may not have been the most effective, the appraisal goes on in the next paragraph to state that "54,600 STB of oil and 54,600 Mcf of gas are recoverable from each successful well drilled on this tract." The estimated recoverable reserves from the successful wells drilled were used to support the assertion that the parcel is comparable to Parcel No. 9, as described above.

BLM analyzed comparable sales at pages 5 and 6 of its appraisal and based fair market value on bonus bids received for comparable Federal and State tracts as well as published data for private leasing in Newaygo County. Parcel 10 was compared with one other Federal parcel (parcel 9) and six state parcels. Appellant challenges BLM's comparable sales analysis on the basis of information obtained from Michigan Oil and Gas Brokerage Service. Appellant asserts that one of the crucial factors in evaluating comparable sales is the "sliding scale royalty (12.50 percent to 25 percent) and a greater delay rental than is normally experienced in oil and gas leases obtained from private individuals" (SOR at 5). Appellant charges that simply comparing bonus bids fails to take into account the vastly different terms of various types of leases. These arguments are effectively met in BLM's response memorandum:

[Differing lease terms], which admittedly can affect a parcel's FMV, were analyzed, but adjustments were not necessary because little or no difference exists between Federal and other leases in Michigan that would warrant change in the appraised FMV's of the Federal oil and gas interests.

The facts are that the royalty rate on Federal leases ranges from 12.5 to 25 percent depending on the daily production from the lease. A 12.5 percent royalty rate is applied to production of the first 50 barrels of oil per day (BOPD). Data from the Petroleum Information Corporation show that initial production from each well drilled to the Traverse Lime and Reed City Dolomite in the Goodwell Field (Parcel No. 10) \* \* \* was less than 50 BOPD. Thus, the royalty rate expected to be applied to the reserves of [this parcel], for purposes of the comparable sales analysis, is 12.5 percent. The most common royalty rate for private leases in Newaygo County, Michigan, in December 1984 was 12.5 percent according to data published in Petroleum Land Data, Inc.'s U.S. Lease Price Report. The royalty rate applied to State of Michigan oil and gas leases offered in the State's December 10, 1984 sale is 16.7 percent. Comparison of the different leases indicates that the Federal royalty rate is the same as the rate for most private leases, and is less than that for State of Michigan leases.

Adjustments in the FMV of each parcel on the basis of rental fee variations are not necessary because the absolute dollar differences between the various leases (Federal, private, and State) are minimal, and the effect of these differences on the FMV of each parcel is not significant relative to drilling, completion, and operating costs. The specific facts are that the Federal rental fee is \$3.00 per lease acre per year, until commencement of production. The rental fee on State of Michigan leases is \$2.00 per lease acre per year after the second year, until commencement of production. The most common rental fee for private leases is \$1.00 per acre per year, until commencement of production.

The important point in this matter concerning the FMV analysis for Parcel No. 10 is that the BLM appraised value was based on presale comparable sales methodology. Our presale estimate of FMV is supported by the results of our postsale analysis, which primarily incorporated a \$26-per-acre bonus bid received for a geologically comparable Federal tract from the same sale. [Emphasis added.]

[3] Appellant also argues that BLM's appraisal does not support its decision because it failed to take into account the fact that appellant's bid was the only one received for parcel 10. BLM's response memorandum discusses the lack of competitive interest in the parcel, and correctly points out that there is not necessarily a direct relationship between lack of bids and fair

market value of the parcels because many factors, such as low parcel value, limited financial resources, lack of significant data, and speculative nature of the tracts, have a bearing on the number of bids received. As we stated in Edward L. Johnson, supra at page 256: "A lack of competitive interest offers very little evidence with regard to the actual fair market value of the land for oil and gas leasing."

Having examined the submissions of both parties, we find that BLM has demonstrated a rational basis, supported by a reasoned explanation in the record, for its conclusion that appellant's bid did not represent fair market value on parcel 10.

[4] Once the Government has presented sufficient documentation establishing the correctness of its fair market value estimate, the burden shifts to appellant to show not only that the Government's estimate did not constitute fair market value but also that its bid does represent fair market value. Burton/Hawks, Inc., 85 IBLA 193, 195 (1985); Kevin J. Bliss, 82 IBLA 31, 33 (1984). Appellant's geological evaluation demonstrates that geologic experts may disagree on essentially the same information, but it does not establish that BLM's evaluation does not constitute fair market value. In this case, a reasoned analysis has been provided upon which the Department may rely and we find appellant has not disproved BLM's estimate of fair market value. Our finding renders consideration of the correctness of appellant's bid unnecessary.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decision appealed from is affirmed.

John H. Kelly  
Administrative Judge

We concur:

Anita Vogt  
Administrative Judge  
Alternate Member

C. Randall Grant, Jr.  
Administrative Judge

